91-369
No. ______

In The

Supreme Court of the United States

October Term, 1991

LILTON CHESSON JR. and
RANDALL CHESSON,

Petitioners,

v.

THE UNITED STATES,

Respondent.

**Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit**

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED FOR REVIEW

In a criminal tax evasion prosecution under 26 U.S.C. § 7201, has the government, as a matter of law, met its burden of proof on the element of a tax due and owing, by virtue of an after-the-fact reclassification by the IRS of corporate expenditures for personal items as a taxable constructive dividend, despite the uncontroverted testimony that the defendants' tax preparer negligently failed to reclassify the corporate expenses as loans to shareholders as a result of which there would have been *no* tax deficiency?

PARTIES TO THE PROCEEDING IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

(1) Petitioners, Lilton Chesson, Jr. and Randall Chesson

(2) Respondent, the United States of America

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OPINION OF THE COURT BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit, (No. 90-4416) whose opinion is herein sought to be reviewed, was rendered on June 3, 1991, and is set forth at Appendix A.

STATEMENT OF JURISDICTION

The opinion of the Court of Appeals for the Fifth Circuit, which affirmed the judgment of the district court, was rendered on June 3, 1991.

This petition is being filed within ninety (90) days of that date, in accordance with Rule 13 of the Rules of the Supreme Court. This Honorable Court has jurisdiction over this proceeding pursuant to Title 28, United States Code, Sections 1254(1) and 2101.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Due Process Clause of the Fifth Amendment of the United States Constitution:

> [No person shall be] deprived of life, liberty, or property without due process of law . . . .

> Title 26, United States Code, Section 7201:

> Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be

> fined not more than $100,000 ($500,000 in the case of a corporation), or imprisoned not more than 5 years, or both, together with the costs of prosecution.
>
> Title 26, United States Code, Section 7206(1):
>
> Any person who [w]illfully makes and subscribes any return, statement, or other document, which contains or is verified by a written declaration that is made under the penalties of perjury, and which he does not believe to be true and correct as to every material matter . . . shall be guilty of a felony and, upon conviction thereof, shall be fined not more than $100,000 ($500,000 in the case of a corporation), or imprisoned not more than 3 years, or both, together with the costs of prosecution.

STATEMENT OF THE CASE[1]

Lilton Chesson, Jr. and his brother, Randall Chesson, were each convicted on three counts of tax evasion, in violation of 26 U.S.C § 7201, and one count of conspiracy to obstruct the tax collection function of the Internal Revenue Service, in violation of 18 U.S.C. § 371. In the trial court the government contended that the Chessons paid personal and church-related expenses through their closely-held corporations, then treated those expenditures as deductible business expenses in order to defraud

[1] References to the Fifth Circuit Court of Appeals opinion are designated by "App. I," followed by a corresponding reference to the page number in the appendix where the cited passage appears.

the Internal Revenue Service. The Chessons' appeal focused on the sufficiency of the government's evidence on the elements of (1) willfulness and (2) the existence of a tax due and owing, both necessary in order to sustain a conviction for tax evasion. The Chessons now contend that the appellate court, in affirming their convictions and holding that the government met its burden of proof on the element of a tax due and owing, erred, and in so doing not only shifted the burden of proof on that element to the defendant, but also misconstrued what proof is relevant to a determination of that issue.

In 1970 the Chessons' father founded Chesson Oil Corporation. Four years later, defendant Lilton Chesson, Jr. took control of Chesson Oil and also formed a sister company, Cameron Offshore Services. His brother Randall assisted Lilton in managing the companies, and since 1975, also acted as the full-time pastor of Parkview Baptist Church and as its school director.

The undisputed testimony at trial was that during the three years at issue, the corporation paid in excess of $285,000 of the Chessons' personal expenses and paid in excess of $300,000 of church-related expenses. The corporate accounting department, with full awareness that these expenses were being paid out of the corporate coffer, routinely processed and paid these expenses. As the Fifth Circuit stated:

> At least from 1981 through 1983, the corporations paid a wide variety of Lilton and Randall's personal expenses. These expenses included personal travel, vehicle repair, sporting goods, home maintenance and improvements, home furniture, electronic equipment,

> legal fees and jewelry, as well as other personal items billed to their corporate American Express cards. The accounting department knew that the corporation was paying these personal expenses. Such invoices, many patently relating to personal items, were routinely processed and paid in the same manner as legitimate business expenses. The invoices were also filed in the same way, by vendor, and clearly labelled. (App. I, at 4-5.)

During the years at issue the corporation retained two different accounting firms to develop year-end financial statements, to render unqualified opinions as to their material accuracy, and to prepare the corporate and individual tax returns. The accounting firms had access to all financial records, including all paid invoices whether relating to business, personal or church-related expenditures. Despite the fact that payment of numerous personal and church-related expenses was clearly reflected in the corporations' invoices (some of which were actually examined by the accountants), neither accounting firm reclassified a single non-corporate expenditure.

The Fifth Circuit opinion makes it quite clear that the accountants should have, in the normal course of their audit, discovered the non-corporate expenditures and that the Chessons did nothing to hinder such discovery:

> The firms sent a team of auditors to the corporate headquarters. The auditors dealt primarily with Kathy Baham, but they had access to all corporate financial records including all paid invoices. Neither firm had any significant contact with Lilton or Randall Chesson. Though neither accounting firm discovered a single invoice involving non-corporate expenditures, there is no dispute that in the three years at

> issue the corporation paid personal expenses in excess of $285,000 and church-related expenses of over $300,000. In the same period approximately 700 invoices involving non-corporate expenses were processed through the companies. (App. I, at 7-8.)

To the objective observer, as the judges of the Fifth Circuit noted, "the accountant's conduct looks like deliberate ignorance . . . . " (App. I, at 16.) This position was reinforced by the *only* accountant-expert who testified at trial (Greg Hext):

> Hext expressed the opinion that the internal audits by both accounting firms were substandard, inadequate, and professionally irresponsible. He drew attention to what he termed "red flags" – circumstances that should have raised serious concerns in the minds of the auditors, prompting direct inquiries aimed at discovering improper expenses in the companies' books. The prior audit and resulting disallowances were enough in themselves, he asserted, to justify pointed questioning of both Randall and Lilton Chesson. Hext also stated that any accountant should know that certain company accounts are likely to mix personal items with legitimate business expenses, especially in a closely-held corporation. There were also simple and direct signals from the numbers. The ratio of yearly expenses in repairs and maintenance to company assets was a plain signal according to Hext. Hext testified that in one year this ratio exceeded 1:3. Finally, the company kept vendor files for firms dealing in such things as men's clothing, Christian books, sporting goods, and pool cleaning. (App. I, at 15.)

The uncontroverted testimony at trial established that had the accountants properly audited the corporate financial

records, the personal and church-related expenses could have been, and should have been, reclassified with no resulting tax impact on the corporations or the Chessons.[2] This was the consistent testimony of every accountant who was questioned about the matter, including the actual tax preparer, the independent CPA expert and two experienced IRS revenue agents, one of whom was also a CPA.

Thus, with respect to the church-related expenses, they should properly have been reclassified as corporate contributions, which like repairs and maintenance, is a deductible corporate expense. Alternatively, the expenditures on behalf of the church could have been treated as additional compensation to Lilton and Randall who in turn would have been entitled to deduct this additional sum as a charitable contribution.

With respect to the personal items, every accountant testified they would have reclassified these personal items as loans to shareholders, and that such reclassification would have been perfectly appropriate. There were such loan accounts on the corporate books for both Lilton and Randall. In fact, at the end of 1981, the Chesson Oil Corporation owed Lilton $56,942.52 for monies he had loaned the corporation. Thus, the $51,292.39 expended on his behalf in 1981 should have simply reduced the balance owed him without any tax consequences. In other

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[2] Because only the Chessons and not their corporations were charged in the indictment, only the tax liability of the Chessons individually is at issue. The church-related expenditures, although important to fully understanding the facts, were only germane to the tax liability of the corporations and the conspiracy to defraud the IRS under count 7.

words, the Chessons received no tax benefit for deducting the personal and church-related expenditures as business expenditures to which they were not otherwise entitled.

The Court of Appeals, in reviewing defendants' claim that the evidence was insufficient to establish a tax due and owing, relied on the above facts but held that the government had met its burden of proof. In doing so it acknowledged that the only evidence adduced of additional taxable income was that "in recommending this case for criminal prosecution . . . Agent Holland classified these [admittedly] personal expenses as constructive dividends."[3] The court then went on to articulate the extraordinary position in a criminal case that, *"[w]ithout evidence that the Chessons intended* to take loans from the corporations, the IRS must view personal expenses made by the companies for their benefit as taxable shareholder income," and that "[t]his case would be different if the evidence *inevitably* pointed to the conclusions that the personal expenditures involved were intended as loans . . . . " (App. I, at 18) (emphasis added). The court concluded that without such evidence being provided by the defendant, "the IRS is not at liberty to retroactively reclassify disallowable business expenses." (App. I, at 17.)

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[3] This classification is triggered by section 316 of the Internal Revenue Code which provides, "For purposes of this subtitle, the term 'dividend' means any distribution of property made by a corporation to its shareholders . . . out of its earnings and profits of the taxable year . . . without regard to the amount of the earnings and profits at the time the distribution was made."

ARGUMENT AND REASON FOR GRANTING THE WRIT

The Court of Appeals has decided an important question of federal law, that has not been, but should be, settled by this Court.

Most tax evasion prosecutions under 26 U.S.C. § 7201 focus on the elements of willfulness and not the element of "a tax due and owing." But without proof beyond a reasonable doubt of the latter, it is immaterial how strong the government's evidence is on the issue of willfulness. At the appellate level defendants raised the adequacy of the government's proof on *both* critical elements. The court held that although "the accountants' conduct looks like deliberate ignorance . . . the Chessons have no safe harbor," because "good faith reliance on one's accountants is not a complete defense to willful tax evasion," and thus, "the question of willfulness is not removed from jury consideration." (App. I, at 15-16.)

Defendants do not here contest this holding *with respect to willfulness,* since there was other evidence in the case from which the jury could arguably have concluded that defendants acted willfully. But the same is not true with respect to the existences of a tax due and owing. On that critical element[4] the government's *only* proof was the revenue agent's after-the-fact classification of certain corporate business expenditures for personal items as taxable constructive dividends, while the undisputed trial testimony was that the accountant/tax preparers could have, and should have, reclassified the

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[4] Under 26 U.S.C. § 7201, the tax evasion statute, a tax deficiency is one of three elements necessary for a conviction. *Sansone v. United States,* 380 U.S. 343, 351 (1965).

expenses so as to eliminate any additional tax obligation to the Chessons or the corporation.

While it may be perfectly proper in the *civil* tax context to permit IRS to reclassify impermissible corporate expenses as taxable constructive dividends and put the burden on the taxpayer to prove otherwise, the same cannot be true in a *criminal* tax case where the burden, constitutionally, must always remain on the government. *In Re Winship,* 397 U.S. 358 (1970). In this case, without any recognition of the distinction between a civil tax case and a criminal tax case, the court impermissibly shifted the burden of proof to the taxpayer. Moreover, since the crime only occurs upon the filing of the tax return, how can the taxpayer's criminal culpability on a critical element be wholly predicated upon the objectively demonstrated negligence of his tax preparer?

Because the contested element in most criminal tax cases is defendant's state of mind, i.e., his "willfulness," understandably far less attention has been focused on the existence of the tax deficiency, although proof of both are equally necessary to sustain a criminal conviction. Proof of willfulness is of a subjective nature. For this reason "good faith reliance" on a tax preparer is only one factor among a universe of facts impacting upon defendant's subjective state of mind and may not, as in this case, carry the day with the jury on the issue of "willfulness."

But the existence of a tax due and owing is wholly dependent upon objective facts (*e.g.*, omitted or overstated sales, understated or overstated interest deductions, the failure to utilize, or the improper utilization of, income averaging). If, given the objective factors, there is

no tax deficiency, then the case cannot withstand a motion for judgment of acquittal at the conclusion of all the evidence and should be dismissed by the trial court.

Among the objective facts susceptible of proof is that a competent tax preparer, acting according to the standards of his profession, should classify a particular financial transaction so as to eliminate any taxable consequence. If the uncontroverted proof at trial is that the tax preparer was retained by defendant to prepare his tax return, and that he could have, and should have, made such a classification but negligently failed to do so, then correction of his omission must be taken into account in objectively determining whether a tax is due and owing. The issue is not good faith reliance on the tax preparer to negate a subjective element, but simply affording defendant taxpayer in a criminal case the benefit of that to which he is entitled from a professional operating under the standards of his own profession.

This Court has, on any number of occasions in recent years, addressed the issue of "willfulness," *see e.g., United States v. Bishop*, 412 U.S. 346 (1973); *United States v. Pomponio*, 429 U.S. 10 (1976), but not since *Holland v. United States*, 348 U.S. 121 (1954), has it addressed the nature of the government's proof of a tax deficiency, and then only in relation to the government's use of indirect methods of proof. Left without direction from this Court, the lower federal courts have applied rules appropriate in the civil tax context to a criminal case which permits the government to satisfy a critical element of the crime in a manner inconsistent with the due process to be afforded a defendant in a criminal case. In effect, the courts have virtually eliminated the need for the government to prove a tax

deficiency once willfulness has been established. Ironically, the circuit courts almost uniformly hold the government to a higher standard of proof on the existence of a tax deficiency in a *civil fraud* case than in a criminal tax prosecution. The case at bar presents an ideal vehicle for this court to set appropriate guidelines consistent with due process for the handling of the tax deficiency element in a criminal tax case.

I.

There is no tax due and owing under 26 U.S.C. § 7201 when the evidence demonstrates that despite the inclusion on the tax return of disallowable deductions or unreported income, the tax preparer omitted other permissible deductions or overreported other income so that once these adjustments are taken into account, there is no tax deficiency. *See, United States v. Apodaca,* 666 F.2d 89 (5th Cir.) *cert. denied,* 459 U.S. 823 (1982); *United States v. Campbell,* 351 F.2d 336 (2d Cir. 1965) *cert. denied,* 383 U.S. 907 (1966); *United States v. Shavin,* 320 F.2d 308 (7th Cir.) *cert. denied,* 375 U.S. 944 (1963); *United States v. Small,* 255 F.2d 604 (1st Cir. 1958); *Elwert v. United States,* 231 F.2d 928, 933 (9th Cir. 1956); *United States v. Bender,* 218 F.2d 869 (7th Cir.) *cert. denied,* 349 U.S. 920 (1955). And this is true despite the fact that other evidence in the case may reek of willfulness. In this case, when the disallowed expenditures are properly classified, defendants likewise have no tax due and owing despite other evidence indicative of willfulness.

When a defendant in a criminal case demonstrates that the tax preparer mistakenly omitted deductions or

overreported income on his return which offsets the deficiency, the determination of a tax due and owing is not limited to an examination of the tax return as filed, but focuses instead on *all* those objective facts germane to the issue of whether a tax is in fact due and owing for the year in question. By this same logic the existence of a tax deficiency should not be limited to an examination of a defendant's return when he seeks to reclassify a disallowed expenditure that was not properly classified by the tax preparer.

There is no meaningful distinction between the two situations. In each instance only as a result of the tax preparer's omission is a tax due and owing. It makes no difference that the omission was perfectly innocent or was the result of gross professional negligence. When the error, which is susceptible of objective verification, is taken into account, the tax deficiency evaporates. While it may be perfectly appropriate in the *civil* context to hold the taxpayer responsible for his tax preparer's negligence and assess the applicable *civil* negligence penalty[5], in the criminal context, if there is no tax deficiency but for the negligent act of a third party, then there can be no conviction under 26 U.S.C. § 7201.

II.

There was no dispute at trial that corporate expenditures for personal items of a shareholder must be classified in one of three ways: as a loan to the shareholder; as

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[5] *See* 26 U.S.C. § 6653.

compensation to him as a corporate officer; or as a constructive dividend. *Only* the auditing revenue agent classified the disallowed corporate expenditures as constructive dividends, and hence taxable in the absence of proof that the taxpayers intended such expenses as loans from the corporation. On the other hand, every CPA witness, including a revenue agent not involved in the prosecution, the actual tax preparer himself, and defendants' independent expert testified that the "correct" classification of the corporate expenses in question from an accounting viewpoint was as loans to shareholder, and therefore non-taxable, irrespective of the taxpayer's intent.[6]

The holding of the court below was that:

> The IRS is not at liberty to retroactively reclassify disallowable business expenses. Without evidence that the Chessons intended to take loans from corporations, the IRS must view personal expenses made by the companies for their benefit as taxable shareholder income. (App. I, at 17-18.)

In so ruling the court implicitly rejected as irrelevant any testimony that the tax preparer could have, and should have, reclassified the expenses as non-taxable loans to shareholders. In effect, the negligence of the tax preparer in failing to make the appropriate classification was

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[6] The substance of the CPAs' testimony was that an accountant is duty bound to minimize the taxpayer's tax obligation, subject of course to the constraints of the applicable professional standards, but that no CPA would classify a corporate expenditure for personal items as a taxable constructive dividend.

deemed irrelevant, although there was no tax due and owing but for such negligence. In so ruling, the court below adopted a standard of proof arguably appropriate in the *civil* tax context, given the statutory scheme, but entirely improper in the criminal context.

III.

The Fifth Circuit's opinion in this case devotes little analysis to the government's proof of a tax due and owing, and considers the significance of the accountants' role *only* as it relates to the issue of willfulness. (App. I, at 16-18.) But the Fifth Circuit is not alone in its superficial treatment of the adequacy of the government's proof of a tax due and owing. For example, in *Davis v. United States,* 226 F.2d 331 (6th Cir. 1955) *cert. denied,* 350 U.S. 965 (1956), defendant claimed that the government had failed to meet its burden of proof that disallowed corporate expenditures were in fact dividends because the government did not prove that the corporation had a surplus from which it could pay dividends. The Sixth Circuit rejected this contention holding that if the government shows that disallowed business expenditures benefitted the defendant, then for *criminal* tax purposes the income is automatically deemed taxable. *Id.* A number of circuit courts have adopted the holding of *Davis. United States v. Williams,* 875 F.2d 846 (11th Cir. 1989); *United States v. Miller,* 545 F.2d 1204 (9th Cir. 1976) *cert. denied,* 430 U.S. 930 (1977); *United States v. Goldberg,* 330 F.2d 30 (3rd Cir.) *cert. denied,* 377 U.S. 953 (1964); *United States v. Hartman,* 245 F.2d 349 (8th Cir. 1957).

In contrast, in the context of a *civil fraud* case, the courts have uniformly agreed that unless the government proves that the corporation which paid the alleged corporate dividends did have sufficient surplus to pay dividends, then the government has failed to meet its burden on proof on the element of a tax due and owing. *Simon v. Commissioner*, 248 F.2d 369 (8th Cir. 1957); *Demmon v. United States*, 321 F.2d 203 (7th Cir. 1963); *Dizenzo v. Commissioner*, 346 F.2d 122 (2nd Cir. 1965); *Truesdell v. Commissioner*, 89 T.C. 1280 (1987).

No lower federal court has provided an adequate explanation why the government's burden of proof in a criminal tax case is less than in a *civil* tax fraud case – because there is no adequate explanation. In *Miller*, 545 F.2d at 1214, the Ninth Circuit was extraordinarily blunt when it explicitly held that the government need not fulfill its burden on the issue of a tax due and owing because the only important element in a criminal prosecution for tax evasion is the element of willfulness.[7]

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[7] The court held:

> The difficulty in *automatically* applying the constructive distribution rules to this case is that it completely ignores one essential element of the crime charged: the willful intent to evade taxes, and concentrates solely on the issue of the nature of the funds diverted. That latter aspect is not the important element. Where the taxpayer has sought to conceal income by filing a false return, he has violated

(Continued on following page)

By so holding, the court also ignored Congress' intent when it drafted 26 U.S.C. § 7201. No matter what evidence of willfulness exists, Congress required a showing of a tax due and owing in a tax evasion case. If the government cannot prove a tax due and owing, it is not deprived of pursuing a criminal action against the taxpayer, since it can and most often does, charge the taxpayer with the filing of a false return under 26 U.S.C. § 7206(1).[8] But in this case the government chose to charge the defendants with tax evasion under § 7201.[9] When the government makes that choice, it should have to fulfill every element of the crime with which it has elected to charge the defendant. That is, it must prove beyond a reasonable doubt there was a tax due and owing.

CONCLUSION

In essence, this case presents to this Court the problem whether defendants' criminal convictions can be sustained, when given proof of willfulness, the fact is

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(Continued from previous page)

the tax evasion statutes. It does not matter that amount could have somehow been made non-taxable if the taxpayer proceeded on a different course. *Id.*

[8] Under § 7206(1) the government need only prove a willfully made material misstatement or omission on a signed return, statement, or other document submitted to the IRS. H. Balter, *Tax Fraud and Evasion,* ¶ 11.04[2][b] (1983).

[9] The maximum penalty for a violation of § 7201 is five years as opposed to three years under § 7206(1).

defendants would not have been charged with substantive tax evasion had it not been for their tax preparer's negligence.

This problem gives rise to a number of questions of law. To what extent can the prosecution predicate its case upon the negligent acts of a third party? What constitutes a tax due and owing? Has the prosecution satisfied its burden of proof on the element of a tax due and owing when the uncontroverted evidence establishes that defendants' accountants negligently failed to reclassify the disallowed business expenditures as loans to shareholders so that there would have been no deficiency? In a *criminal* tax evasion prosecution, does the IRS's automatic reclassification of the disallowed corporate expenditure impermissibly shift the burden of proof onto defendants?

The lower courts need this Court's guidance with respect to how the element of a tax deficiency is to be construed for criminal tax purposes, especially when the finding of a tax due and owing is wholly dependent upon the negligence of defendants' accountant. On the one hand, the courts have repeatedly held that defendants may utilize omitted deductions or over-reported income on their return to negate the existence of a deficiency despite overwhelming evidence of willfulness. On the other hand, some lower courts have held that in a tax evasion prosecution, there is no real need to be overly concerned with whether a tax is really due and owing at all, so long as there is a sufficient showing of willfulness.

The Court has never visited these issues. This case is a perfect vehicle for this Court to articulate what the government must demonstrate in order to establish a tax

due and owing in a *criminal* tax evasion prosecution and to clarify what evidence is relevant in this regard, in much the same way this Court did thirty-seven years ago when it decided *Holland v. United States*.

WHEREFORE, this Court is respectfully urged to enter an order granting petitioners Lilton Chesson, Jr. and Randall Chesson's petition for a writ of *certiorari* to the United States Court of Appeals for the Fifth Circuit.

Respectfully submitted,

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APPENDIX I

UNITED STATES of America,
Plaintiff-Appellee,

v.

Lilton CHESSON, Jr. and Randall Chesson,
Defendants-Appellants.

No. 90-4416.

United States Court of Appeals, Fifth Circuit.

June 3, 1991.

Defendants were convicted in the United States District Court for the Western District of Louisiana, Donald E. Walter, J., of three counts of tax evasion and one count of conspiracy to obstruct tax collecting function of Internal Revenue Service (IRS), and they appealed. The Court of Appeals, Patrick E. Higginbotham, Circuit Judge, held that: (1) there was sufficient evidence of willfulness to support tax evasion convictions; (2) there was sufficient evidence of tax deficiency to support tax evasion convictions; (3) evidence was sufficient to support conspiracy convictions; and (4) District Court was not outside its discretion in ruling that invoice with attached self-adhesive note was adequately authenticated.

Affirmed.

Appeal From the United States District Court for the Western District of Louisiana.

Before GOLDBERG, HIGGINBOTHAM, JONES, Circuit Judges.

PATRICK E. HIGGINBOTHAM, Circuit Judge:

Lilton Chesson, Jr. and his brother, Randall Chesson, appeal their convictions on three counts of tax evasion, 26 U.S.C. § 7201, and one count of conspiracy to obstruct the tax collecting function of the Internal Revenue Service, 18 U.S.C. § 371. At trial the prosecutor argued to the jury that the Chessons channeled through their privately-held companies various personal and church-related expenditures and that in the years 1981 through 1983 they filed corporate and personal tax returns treating such non-corporate expenditures as deductible business expenses. On appeal the Chessons argue that the government failed to adduce sufficient evidence of willfulness. They contend that it was never shown that they attempted in any manner to conceal the fact that the corporations were paying these non-business expenses; to whatever extent they knowingly allowed the corporations to bear these expenses, they argue that they were reasonably relying upon their accountants to correct any errors in classification. Relatedly, the Chessons dispute the existence of a tax deficiency. They contend that had the accountants performed as reasonably expected, there would have been no additional tax obligation. We affirm.

I.

Lilton Chesson, Sr. founded Chesson Oil Corporation in 1970. In 1974 Lilton Chesson, Jr. took over active control of the business and, in the same year, formed Cameron Offshore Services, a sister company. Both companies

were closely-held corporations engaged in the oil and gas production and marketing business. Lilton Chesson was the chief executive officer of the related companies in the years in issue. Between them, Lilton Chesson and his brother Randall were the companies' sole shareholders. Randall assisted Lilton in managing the affairs of the family businesses, though as of 1975 Randall was also the full-time pastor of Parkview Baptist Church.

Gladys Harbour was the office manager and ranking administrative employee for Chesson Oil and Cameron Offshore Services. The field supervisors of the various company terminals, as well as the head of the accounting department, Kathy Baham, reported directly to Harbour, or to Lilton or Randall Chesson.

The companies shared one accounting department, although different employees worked exclusively for and were paid by one or the other of the corporations. The companies needed a relatively large accounting staff because they handled a large volume of discrete purchase and sale transactions. It was the job of the accounting staff to keep close track of accounts payable and receivable. In the years at issue the companies processed as many as 10,000 invoices for purchases per year. Files were kept by vendor of all accounts payable. Invoices received in the main office would be stamped with a processing block with all information needed for payment. This information included: (1) the company to be billed – either Chesson Oil, Cameron Offshore, or one of their subsidiaries; (2) the terminal involved; (3) the date; (4) the account code number; (5) the approving authority; and (6) a description of the item or services purchased.

Invoices would be coded by company in the accounting department and then sent out to the appropriate terminal for approval. Lilton and Randall Chesson and Gladys Harbour had the authority to approve invoices in the main office, and each field supervisor had authority to approve invoices at the terminals. Once they were approved and a description of the services entered, the invoices would be sent back to the accounting department. There they would be coded, journalized, and set up for payment. Coding decisions were usually made by the accounts payable supervisors. When they had questions they would go to Kathy Baham, who in turn directed her questions to Gladys Harbour or either of the Chessons.

Because of the potential for confusion of overlapping corporate entities, Gladys Harbour directed the accounting personnel to be vigilant to ensure that all invoices were charged to the correct corporate entity and that the invoices so indicated. In the earlier years invoices addressed to the wrong entity would be returned to the vendor with instructions to create a new, corrected invoice. As the company grew it became apparent that these procedures could no longer assure prompt payment on all accounts payable. Thus, at the direction of Lilton Chesson, Gladys Harbour instructed the accounting staff to make the necessary modifications of invoices internally. Every paid invoice, with the check stub, was filed according to vendor.

At least from 1981 through 1983, the corporations paid a wide variety of Lilton's and Randall's personal expenses. These expenses included personal travel, vehicle repair, sporting goods, home maintenance and improvements, home furniture, electronic equipment,

legal fees, jewelry, as well as other personal items billed to their corporate American Express cards. The accounting department knew that the corporation was paying these personal expenses. Such invoices, many patently relating to personal items, were routinely processed and paid in the same manner as legitimate business expenses. The invoices were also filed in the same way, by vendor, and clearly labelled.

All work done on Lilton's or Randall's personal residences was supervised by Rodney Guidroz, the field supervisor of the Chloe terminal. When an invoice for such work came to the company it was sent to Guidroz for approval. In filling out the processing stamp Guidroz would normally put the initials "LC" or "RC" in the space allotted for description of the purchase. This was Guidroz's code for work done at either Lilton's or Randall's home. Occasionally, invoices for personal items would be sent to Randall or Lilton at their homes. As a matter of routine, the accounting department would change the addressee on these invoices in the same way it changed invoices addressed to the wrong corporate entity. Each of the Chesson employees who testified denied ever being told to conceal the fact that the corporation was paying for personal items and services for Lilton and Randall Chesson.

In 1980 Parkview Baptist Church began to renovate and reconstruct the church and its school. The contributions of church members to the building fund were modest compared to the cost of the project. But it was understood by the church that Randall and Lilton would supplement the building fund as necessary. From 1981 through 1983 the Chessons through their corporations

paid nearly $700,000 in project costs. These payments were treated by the Chessons and the church as a gift.

It was also common knowledge among Chesson employees that the company was paying for the construction of the new church and school. Lilton Chesson met with Rodney Guidroz and David Stayshich, a staff engineer, and informed them that this venture would be undertaken, in part, by company employees and paid for, in whole, by company funds. The new church structures were designed by Stayshich. Rodney Guidroz functioned as the general contractor for the project. He and his subordinates did much of the carpentry work but they also subcontracted certain specialized jobs. Lilton told Guidroz to charge the company for these outside costs and, for accounting purposes, to use the designation "R & M," indicating the repairs and maintenance account, on all invoices. At a later date Lilton directed Guidroz to begin billing church construction costs at Cameron Offshore instead of Chesson Oil.

Again, invoices were sometimes addressed to the Parkview Baptist Church. As with the other invoices, these would be changed to conform the addressee to the paying entity. Even after these changes, many invoices plainly related to work done for the church. Several invoices mentioned the name of the church in the description. Some also contained words evidencing that they were church-related expenses – words such as "sanctuary," "alter," or "pew." While addressee changes to these invoices were routinely made, the description sections of several were also found to have been changed. These changes included obliterations of the name of the church or other church-related references. None of the

Chesson employees that testified admitted knowledge of such changes. All of the employees that testified denied ever being told by Randall or Lilton Chesson to conceal the fact that the company was making these expenditures on behalf of the church.

In early 1980, the IRS audited the 1978 corporate tax return of Chesson Oil Corporation. This was a routine civil audit, but it did result in certain disallowances. Phyllis Hodgkins, the revenue agent who conducted the audit, found in the corporation's books certain improper church-related expenses as well as personal expenses for both Randall and Lilton Chesson. Agent Hodgkins reclassified the personal items as additional compensation to Randall and Lilton, creating additional tax obligations for each of them. The church-related expenditures, on the other hand, she simply reclassified as corporate charitable contributions, creating no additional tax obligations for the corporation. Agent Hodgkins then discussed the disallowances with Randall and Lilton individually and obtained their signatures on an agreement to assume the additional tax liabilities.

During the years in issue the corporations retained two different accounting firms to develop year-end financial statements and to render unqualified opinions as to their material accuracy. The firms sent a team of auditors to the corporate headquarters. The auditors dealt primarily with Kathy Baham, but they had access to all corporate financial records, including all paid invoices. Neither firm had any significant contact with Lilton or Randall Chesson. Though neither accounting firm discovered a single invoice involving non-corporate expenditures, there is no dispute that in the three years at issue the

corporations paid personal expenses in excess of $285,000 and church-related expenses of over $300,000. In the same period approximately 700 invoices involving non-corporate expenses were processed through the companies.

The IRS began an audit of the 1981 Chesson Oil Corporation tax return in May 1984. Later, the audit was expanded to include the returns of Cameron Offshore Services and both Lilton and Randall Chesson and was extended to each of the years 1981 through 1983. Robert Holland was the revenue agent initially assigned to the audit. Within the first thirty days Agent Holland questioned several corporate expenses. He first approached Kathy Baham, but was then directed to Lilton Chesson.

Holland testified at trial that Lilton Chesson lied when they first discussed the invoices. When asked about one invoice designated as an "R & M" expense out of the Chloe terminal, Lilton reportedly stated that it involved some "company property." Yet this particular invoice was later identified by Rodney Guidroz as involving work performed at the Parkview Baptist Church. When Holland asked Lilton about a $10,000 invoice from a travel agency directed to "Mrs. Randall Chesson," Lilton identified the invoice as covering the costs of a church trip to Biloxi, Mississippi. Other invoices questioned by Holland in this first meeting with Lilton Chesson included construction and materials for a fence around his home. Lilton argued that this was a valid business expense, necessitated by threats to his family's security by unruly employees. Another invoice was for legal fees paid by Lilton Chesson in defense of a restrictive covenant suit arising out of the construction of the fence. This, too, Lilton argued was a legitimate business expense.

After this meeting, convinced that the corporate books contained both church-related expenses and what appeared to be personal expenses, Agent Holland referred the case for criminal prosecution. Special Agent Mark Kroczynski conducted the criminal investigation. The investigation spanned several years, culminating in Kroczynski's recommendation that both Randall and Lilton Chesson be prosecuted for tax evasion and conspiracy.

Several Chesson employees testified at trial. Though each testified to personal knowledge of the extensive practice of corporate payment of personal and church-related items, all denied being asked to conceal this fact. The testimony of Kathy Baham is particularly noteworthy. Unexplainably, she denied knowing anything of the non-corporate expenses that were being passed through the companies' books. More importantly, though, Baham testified concerning a conversation she had with Randall Chesson following her plea of the privilege against self-incrimination before the grand jury. According to Baham, Randall Chesson came to speak with her at that time, upset that she had pled the Fifth Amendment. She insists that he told her: "Put the blame on me, I told you to alter the invoices, I told you to code them, the most I'll get is community service."

The prosecution placed great emphasis on this testimony, depicting Randall's statement as an admission of guilty knowledge. But Government Exhibit 32-416(b) was even more important to the prosecution's case. This exhibit was one of several invoices originally addressed to the Parkview Baptist Church from Chaisson Electric Company for work performed at the church. This invoice

was significant because allegedly attached to the original was a self-adhesive note, a "post-it," that read, "Sara Brou – please send me the original and all the other copies of this invoice that you have. LC." Also, there was a copy of the same invoice with the words "Parkview Baptist Church" obliterated that had a second post-it attached to it with the words, "Sarah, the attached is to replace the one you sent me, please discard all other copies you presently have and use these in its place. LC."

Sarah Broussard was the only Sarah that worked in the corporations' accounting department. She supervised accounts payable exclusively for Cameron Offshore. Sarah Broussard testified, out of the jury's presence, that the handwriting appeared to be Lilton Chesson's, but she insisted that she had never seen the invoice or the post-its. Based on her testimony, and the fact that the invoice was one paid by Chesson Oil, not Cameron Offshore, the district court initially excluded this invoice and the post-its from evidence. However, the court later reversed its ruling after hearing the testimony of Agent Kroczynski, who maintained that he specifically remembered seeing the post-its affixed to the particular Chaisson Electric invoice when he culled the Chaisson invoices in preparation for an interview with the company's owner, Bart Chaisson.

II.

The Chessons argue on appeal that the evidence produced at trial was not sufficient to sustain their convictions for tax evasion and conspiracy. Though they readily admit that they used significant amounts of company

funds to pay personal and church-related expenses in the years in question, they steadfastly deny that they ever intended, much less conspired, to evade taxes. According to the Chessons, the funds expended by the corporations on their personal behalfs were intended as loans to them as shareholders; the church-related expenses, on the other hand, were intended as corporate charitable contributions. The error, they contend, was one of classification. And this error was committed by their accountants, not themselves. The Chessons argue that their accountants were negligent in not discovering and reclassifying these various non-corporate expenses. Had the auditors done their job, the argument continues, the expenses would have been properly reclassified and there would have been absolutely no tax impact, either for them personally or for the corporations.

In weighing the sufficiency of the evidence, we must view the evidence in the light most favorable to the government, accepting all reasonable inferences and credibility choices that support the jury's verdict. *United States v. Gonzales,* 866 F.2d 781, 783 (5th Cir.), *cert. denied,* 490 U.S. 1093, 109 S.Ct. 2438, 104 L.Ed.2d 994 (1989). A jury is free to choose among reasonable constructions of the evidence. *United States v. Bell,* 678 F.2d 547, 549 (5th Cir. 1982), *aff'd,* 462 U.S. 356, 103 S.Ct. 2398, 76 L.Ed.2d 638 (1983). We may reverse only if a rationally-minded trier of fact would necessarily have entertained a reasonable doubt as to the existence of any essential element of the charged offense. *United States v. Nixon,* 816 F.2d 1022, 1029 (5th Cir.1987), *cert. denied,* 484 U.S. 1026, 108 S.Ct. 749, 98 L.Ed.2d 762 (1988). After a thorough review of the record, we are persuaded that the convictions must stand.

A.

Any person who "willfully attempts in any manner to evade or defeat any tax" imposed by the Internal Revenue Code is guilty of a violation of 26 U.S.C. § 7201. The elements of a § 7201 offense are willfulness, a tax deficiency, and an affirmative act of evasion or attempted evasion of the tax. *United States v. Kim,* 884 F.2d 189, 192 n. 1 (5th Cir.1989) (citing *Sansone v. United States,* 380 U.S. 343, 351, 85 S.Ct. 1004, 1010, 13 L.Ed.2d 882 (1965)). The government must prove "every element beyond a reasonable doubt though not to a mathematical certainty." *Holland v. United States,* 348 U.S. 121, 138, 75 S.Ct. 127, 137, 99 L.Ed. 150 (1954).

The Chessons argue that the government failed to adduce sufficient evidence of willfulness. They contend that it was never shown that they attempted in any manner to conceal the fact that the corporations paid non-business expenses. To whatever extent they knowingly allowed the corporations to bear these expenses, they argue that they were reasonably relying upon their accountants to correct any errors in classification. The Chessons also dispute the existence of a tax deficiency. Had the accountants performed as reasonably expected, they argue, there would have been no tax due and owing.

1.

Willful tax evasion is "a voluntary intentional violation of a known legal duty." *United States v. Smith,* 890 F.2d 711, 715 (5th Cir.1989). Evidence of willfulness is ordinarily circumstantial. *Kim,* 884 F.2d at 192, It may

consist of, among other things, "a failure to report a substantial amount of income, a consistent pattern of underreporting large amounts of income, the spending of large amounts of cash that cannot be reconciled with the amount of reported income, or *'any conduct, the likely effect of which would be to mislead or to conceal.'* " *Id.* (citations omitted) (emphasis added).

The jury could reasonably have concluded that the Chessons pursued a consistent practice of underreporting personal taxable income and abusing the corporate entity of their companies despite a prior audit in which the IRS found the Chessons to have mischaracterized personal and church-related expenditures as deductible business expenses. In the years 1981 through 1983 the Chessons charged personal expenses to the companies' accounts of approximately $600,000. No single unequivocal instance of concealment was proved. Nonetheless, the jury could have concluded that the manner in which the Chesson companies dealt with invoices for non-corporate expenses was misleading or concealing. *See Spies v. United States,* 317 U.S. 492, 499, 63 S.Ct. 364, 368, 87 L.Ed. 418 (1943); *Kim,* 884 F.2d at 192. The methods of coding invoices, of obliterating and altering addresses and purchase descriptions, and of destroying certain original invoices all combined to reduce the likelihood of random detection of the improper expenses, or so a jury could conclude. Alone this inference would be thin indeed, but the Chessons' decision to condone these practices shortly after undergoing a civil tax audit for underreporting income puts them in a different light. While yet not compelling, we cannot say that the evidence will not permit an inference of willful criminal conduct.

The jury could also have relied on other testimony in determining that Randall and Lilton Chesson willfully evaded taxes. Agent Holland testified that Lilton Chesson mischaracterized the nature of various invoices when questioned directly. This testimony was corroborated by other witnesses, including Rodney Guidroz, who testified that all "R & M" expenses out of the Chloe terminal involved work done at Parkview Baptist Church and that Lilton directed him to use the R & M account. Kathy Baham testified that Randall Chesson told her to blame him for the way in which the company treated the suspect expenses. In his own words, he had been the one who told her to change and code the invoices, and the most he would have to do was community service.

Finally, the jury could have drawn an inference of willfulness from the altered Chaisson Electric invoice and the post-its attached to it and the original invoice; the jury could have inferred that Lilton Chesson was ordering a Chesson employee to alter and discard documents that might evidence company payment for the benefit of Parkview Baptist Church. The testimony of Sarah Broussard, and the obvious risk that the post-its may not have been attached to these actual invoices, weakens the probative value of this evidence. That we would not draw the inference is of no moment. It was for the jury. Our task is only to decide if the agreed inferences are beyond the pale of rational inference. That question must be answered in favor of the government.

The Chessons argue that whatever proof of willfulness is contained in the record is undermined by proof that they relied in good faith upon the accountants to discover and reclassify any improper expenditures. At

trial the Chessons called Greg Hext, an accountant, as an expert witness. Hext expressed the opinion that the internal audits by both accounting firms were substandard, inadequate, and professionally irresponsible. He drew attention to what he termed "red flags" – circumstances that should have raised serious concerns in the minds of the auditors, prompting direct inquiries aimed at discovering improper expenses in the companies' books. The prior audit and resulting disallowances were enough in themselves, he asserted, to justify pointed questioning of both Randall and Lilton Chesson. Hext also stated that any accountant should know that certain company accounts are likely to mix personal items with legitimate business expenses, especially in a closely-held corporation. There were also simple and direct signals from the numbers. The ratio of yearly expenses in repairs and maintenance to company assets was a plain signal, according to Hext. Hext testified that in one year this ratio exceeded 1:3. Finally, the company kept vendor files for firms dealing in such things as men's clothing, Christian books, sporting goods, and pool cleaning.

The Chessons point to *United States v. Venditti*, 533 F.2d 217, 219 (5th Cir.), *reh'g denied*, 540 F.2d 1086 (1976). *Venditti* holds, however, that even good faith reliance on one's accountant is not a complete defense to willful tax evasion. *Id.* The force of the defense as an abstract proposition aside, the jury was entitled to conclude that the Chessons' reliance upon their accountants to discover and reclassify the impermissible expenses was not in good faith – that they knowingly, or recklessly, withheld from their accountants information concerning the more

than 700 improper invoices at issue in this case, comprising nearly $600,000 in personal and church-related expenses. It is true that the accountants' conduct looks like deliberate ignorance but even if they never asked the Chessons' whether such expenses were in the books the Chessons have no safe harbor. As we held in *Venditti,* where a defendant attributes underpayment of taxes to his accountant's failure to discover and rectify improper expenses, the question of willfulness is not removed from jury consideration. *Id.*

2.

The Chessons also contend that there is insufficient evidence of a tax deficiency. Their argument is that, had the accountants properly audited the corporation, these personal and church-related expenses would have been reclassified with no resulting tax impact for the companies or the Chessons.

There was a great deal of testimony as to the proper timing and method of reclassifying non-business expenses. Most of the testimony confirmed that a corporation's accountants can, and should, reclassify personal and other non-business expenses at the end of the tax year to minimize the client's tax obligations. There are several options. A personal expense may be reclassified as additional compensation to the shareholder, as a loan payable by the shareholder, or as a constructive dividend to the shareholder. The Chessons contend that the personal expenses at issue here could have, if discovered by the accountants, been reclassified as loans payable, resulting in no additional tax obligations. They point out

that the corporate ledgers had accounts for shareholder loans, and that at various times in the past there were such loans, as well as loans from the Chessons to the corporations. In recommending this case for criminal prosecution, however, Agent Holland classified these personal expenses as constructive dividends.

With respect to reclassification of the church-related expenses, the testimony at trial confirmed that an accountant could have reclassified these expenses as corporate charitable contributions up to the limit of five percent of the corporations' income. In 1982 the allowable contribution was raised to ten percent. And though a corporation's charitable contributions in a given year are capped, contributions in excess of this ceiling may be carried over to later years. The accountants might also have been able to treat these expenses as additional compensation to the Chessons, who in turn could claim the expenses as personal charitable contributions. One benefit of this treatment is that individuals can contribute up to fifty percent of their income to charity. Had either of these things been done, before filing, there would have been no tax impact for the corporations or either of the Chessons.

This is where the testimony diverged. The inescapable fact is that none of the questioned expenses was reclassified before filing in any of the relevant years; these expenses were treated in the companies' books and tax returns as deductible operating costs. Contrary to much of what the defendants have argued, the IRS is not at liberty to retroactively reclassify disallowable business expenses. Without evidence that the Chessons intended to take loans from the corporations, the IRS must view

personal expenses made by the companies for their benefit as taxable shareholder income.

To prove a tax deficiency, "the government must show that the taxpayer had unreported income, and second, that the income was taxable." *United States v. Fogg,* 652 F.2d 551, 555 (5th Cir.1981), *cert. denied,* 456 U.S. 905, 102 S.Ct. 1751, 72 L.Ed.2d 162 (1982). There can be no question that the government did that in this case: "full and proper returns would have resulted in larger tax obligations than those shown in the returns actually filed." *Jones v. United States,* 282 F.2d 745, 747 (4th Cir.1960), *cert. denied,* 365 U.S. 842, 81 S.Ct. 799, 5 L.Ed.2d 808 (1961). This case would be different if the evidence inevitably pointed to the conclusions that the personal expenditures involved were intended as loans and the church-related expenditure, above the allowable ceiling, were intended as additional compensation. In that event, "full and proper" returns might not create additional tax liabilities.

We are persuaded that the evidence produced at trial was sufficient to support the jury's verdicts of guilty beyond a reasonable doubt to the charges of willful tax evasion.

B.

Sufficient evidence also existed to support the Chessons' convictions for conspiracy. To sustain a conspiracy conviction under 18 U.S.C. § 371 the government has the burden of proving beyond a reasonable doubt that the alleged conspirators agreed among themselves to

defraud the United States by obstructing the tax collecting function of the IRS. *United States v. Ortiz-Loya*, 777 F.2d 973, 981 (5th Cir.1985). The government also has the burden of proving at least one overt act in furtherance of this agreement. *Id.* Participation in a conspiracy need not be proved by direct evidence; "a common purpose and plan may be inferred from a 'development and collection of circumstances.' " *Glasser v. United States*, 315 U.S. 60, 80, 62 S.Ct. 457, 469, 86 L.Ed. 680 (1942).

Viewing the evidence in the light most favorable to the verdict, we must conclude that there was sufficient evidence that the Chessons conspired as charged. The jury could reasonably have concluded that Randall and Lilton Chesson agreed to divert substantial resources from the Chesson companies to the construction of Parkview Baptist Church, that they agreed to use Chesson employees for the project, and that they agreed to charge the outside costs as a legitimate business expense to the companies' repairs and maintenance accounts. With respect to the personal expenditures made by the companies on behalf of the Chessons, the evidence showed that Randall and Lilton Chesson acted in common, that they agreed to charge personal items to the company, that they agreed to use company employees to perform work on their private residences, and that they agreed to treat these expenditures as corporate expenses, not taxable shareholder income.

III.

We are left only with the question whether the district court erred in admitting into evidence Government

Exhibit 32-416(b), copies of a certain Chaisson Electric invoice with post-its attached. The issue is important, as made plain by our earlier discussion. The Chessons argue that this exhibit was never adequately authenticated. Because of the tendency of post-its to randomly disattach and reattach themselves, they argue, the court could not with confidence have found that this exhibit was in fact what the government claimed it to be – that is, evidence that Lilton Chesson deliberately ordered a subordinate to alter company invoices concerning work performed at Parkview Baptist Church.

In judging the admissibility of this invoice, the court heard testimony from Agent Kroczynski, who maintained that he remembered seeing these notes affixed to these specific invoices when he sorted through the Chaisson Electric bills as part of his pre-indictment investigation of this case. From the papers before us we are dubious. But a proper answer to this question, dependent as it is on context, requires that we remain sensitive to our constitutional role. This is the domain of the trial judge, as reflected by his considerable discretion in making such rulings. We cannot say that the district court was outside the wide reach of its discretion in admitting these items to evidence.

AFFIRMED.

(2)

No. 91-369

In the Supreme Court of the United States

OCTOBER TERM, 1991

LILTON CHESSON, JR., AND
RANDALL CHESSON, PETITIONERS

v.

UNITED STATES OF AMERICA

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*ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT*

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether the evidence was sufficient to establish a tax deficiency.

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OPINION BELOW

The opinion of the court of appeals (Pet. App. 1-20) is reported at 933 F.2d 298.

JURISDICTION

The judgment of the court of appeals was entered on June 3, 1991. The petition for a writ of certiorari was filed on August 30, 1991. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

Following a jury trial in the Western District of Louisiana, petitioners were each convicted on three counts of willfully attempting to evade income tax, in violation of 26 U.S.C. 7201, and on one count of conspiracy to defraud the United States by impairing and impeding the lawful governmental functions of the Internal Revenue Service (IRS), in violation of 18 U.S.C. 371. Pet. App. 2.

1. The evidence at trial showed that petitioner Lilton Chesson was the chief executive officer of Chesson Oil Corporation and its sister company, Cameron Offshore Services. Pet. App. 2-3. Lilton and petitioner Randall Chesson were the sole shareholders of the companies. Randall was also the full-time pastor of Parkview Baptist Church and assisted Lilton in managing the companies. Pet. App. 3.

From 1981 through 1983, the companies paid a large amount of petitioners' personal expenses, including expenditures for travel, vehicle repairs, sporting goods, electronic equipment, legal fees, jewelry, and other personal items that were billed to petitioners' corporate credit cards. Pet. App. 4-5. Employees in the companies' accounting department knew the corporations were paying petitioners' personal expenses. The invoices for personal expenses were routinely processed and paid in the same manner as those for legitimate business expenses. Pet. App. 5. As a matter of routine, the accounting department altered the designation of the addressee on invoices sent to the petitioners' residences. Pet. App. 5-6.

From 1981 through 1983, the corporations also paid almost $700,000 for the renovation and reconstruction of the Parkview Baptist Church and school. Pet. App. 5-6. Lilton told a field supervisor for the

companies to charge the cost of the project to the repairs and maintenance account on the companies' books. Pet. App. 6. Some of the church-related invoices were altered to obliterate the name of the church or other "church-related references." *Ibid.*

During the three years at issue, the companies paid personal expenses of more than $285,000 and church-related expenses in excess of $300,000. Approximately 700 invoices relating to non-corporate expenses were processed through the companies. Pet. App. 7-8. During the years at issue, the companies processed as many as 10,000 invoices per year. Pet. App. 3.

In 1980, the IRS audited the 1978 corporate tax return of Chesson Oil Corporation. The IRS disallowed payments for personal expenses of petitioners and for church-related expenses. The payments for personal items were charged as additional compensation to petitioners and resulted in increased personal tax liabilities for them. The payments for church-related items were allowed as corporate charitable contributions. Pet. App. 7.

In spite of the results of the IRS audit in 1980, petitioners continued to have the corporations pay large amounts of their personal and church-related expenses. During 1981 through 1983, the companies retained two accounting firms to develop year-end financial statements and to render unqualified opinions as to their material accuracy. Pet. App. 7. The accounting firms sent auditors to the companies. Although the auditors dealt with the head of the accounting department and had access to all corporate financial records, apparently neither accounting firm discovered that the companies were paying personal and church expenses and characterizing those payments as business expenses. *Ibid.*

2. The court of appeals affirmed petitioners' convictions. Pet. App. 1-20. On appeal, petitioners contended, *inter alia*, that there was insufficient evidence of a tax deficiency. They contended that their accountants should have reclassified the personal and church-related expenses as loans to petitioners. Pet. App. 16. The court of appeals rejected that contention. The court held that the expenditures could not be reclassified as shareholder loans without evidence that petitioners had intended to take loans from the corporations at the time the payments were made. Pet. App. 16-18.[1]

ARGUMENT

To establish a violation of 26 U.S.C. 7201, the government must prove (1) the existence of a tax deficiency, (2) an affirmative act of evasion or attempted evasion of the tax due, and (3) willfulness. *Sansone* v. *United States*, 380 U.S. 343, 351 (1965); *United States* v. *Helmsley*, No. 90-1012 (2d Cir. July 30, 1991), slip op. 6590-6591; *United States* v. *Williams*, 875 F.2d 846, 849 (11th Cir. 1989). Petitioners argue (Pet. 8-15) that the evidence was insufficient to support the jury's findings that there was a tax deficiency. They assert (Pet. 8-9) that the only proof of a tax due and owing was an IRS revenue agent's "after-the-fact classification of certain corporate business expenditures for personal items as taxable constructive dividends," while the evidence at

[1] The court of appeals also rejected petitioners' arguments that the evidence was insufficient to show that petitioners acted willfully and conspired to obstruct the tax collecting function of the IRS, and that the district court erred by admitting an invoice into evidence. Pet. App. 10-16, 18-20. Petitioners do not pursue those arguments here.

trial showed that petitioners' accountants could have reclassified the expenses as loans to shareholders and thereby eliminated any additional tax liability to petitioners or the companies. Petitioners' argument is meritless.[2]

In order to prove the existence of a tax deficiency, the government must prove (1) that the defendant had unreported income, and (2) that the income was taxable. *United States* v. *Hiett*, 581 F.2d 1199, 1200 (5th Cir. 1978). The government establishes a *prima facie* case by proving the defendant's receipt of funds having the appearance of income. See *United States* v. *Fogg*, 652 F.2d 551, 553-555 (5th Cir. 1981), cert. denied, 456 U.S. 905 (1982); *United States* v. *Miller*, 545 F.2d 1204, 1215 n.13 (9th Cir. 1976), cert. denied, 430 U.S. 930 (1977); *United States* v. *Lacob*, 416 F.2d 756, 760 (7th Cir. 1969), cert. denied, 396 U.S. 1059 (1970); *United States* v. *Garcia*, 412 F.2d 999, 1001 (10th Cir. 1969). It is well settled that a shareholder's willful diversion of corporate funds to pay his personal expenses renders the shareholder criminally liable for understating his personal income. See *United States* v. *Thetford*, 676 F.2d 170, 175 (5th

[2] Petitioners also assert (Pet. 9) that allowing the IRS to reclassify the expense payments as income impermissibly relieved the government of its burden of proving a tax deficiency. As discussed further below, however, the fact that the payments were made for petitioners' benefit, and were not treated as loans on the corporations' books, established a *prima facie* case of a tax deficiency. Although petitioners risked conviction if they failed to rebut the government's *prima facie* case, that is not the same as shifting the burden of proof. See *Holland* v. *United States*, 348 U.S. 121, 138-139 (1954) (rule that government is not required "to negate every possible source of nontaxable income" in a net worth case does not shift burden of proof; "[o]nce the Government has established its case, the defendant remains quiet at his peril.").

Cir. 1982), cert. denied, 459 U.S. 1148 (1983); *United States* v. *Miller, supra; Bernstein* v. *United States*, 234 F.2d 475 (5th Cir.), cert. denied, 352 U.S. 915 (1956); *Davis* v. *United States*, 226 F.2d 331 (6th Cir. 1955), cert. denied, 350 U.S. 965 (1956).

The court of appeals properly found (Pet. App. 16-18) that the evidence at trial, viewed in the light most favorable to the government, was sufficient to support the jury's finding that the corporate funds that were used to pay petitioners' personal expenses constituted taxable income to them rather than loans. Petitioners concede that their companies paid approximately $285,000 of their personal living expenses during the years at issue. Pet. 5. They also concede (Pet. 4-6) that while the corporate ledgers had accounts for shareholder loans (Pet. App. 17), none of the expenditures for petitioners' personal living expenses was recorded as a loan.

Evidence that the companies' accountants could have reclassified the payments at issue as loans (see Pet. App. 16) was insufficient to rebut the government's case. As this Court has held, "[t]ax consequences follow [from] what has taken place, not what might have taken place." *Central Tablet Mfg. Co.* v. *United States*, 417 U.S. 673, 690 (1974). See also *Commissioner* v. *National Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134, 148-149 (1974). In accord with this principle, the courts of appeals generally have refused to allow a criminal defendant to take advantage of some technical approach to the determination of his reporting obligations or tax liability that does not comport with the course actually followed by the defendant. See *United States* v. *Helmsley*, No. 90-1012 (2d Cir. July 30, 1991), slip op. 6595-6600; *United States* v. *Santarelli*, 778 F.2d

609, 617 (11th Cir. 1985); *United States* v. *Cruz*, 698 F.2d 1148 (11th Cir.), cert. denied, 464 U.S. 960 (1983).

Allowing a defendant to avoid prosecution simply by changing his accounting for payments on the eve of trial "would make a mockery of the federal income tax system." *United States* v. *Santarelli*, 778 F.2d at 617. An accused taxpayer in petitioners' position could have his corporation pay all of his bills, deduct the payments as business expenses on the corporate tax returns, and then, if caught, simply reclassify the payments as loans. See *United States* v. *Cruz*, 698 F.2d at 1150-1152; *United States* v. *Helmsley*, slip op. 6597.

The fact that an accountant classifies the payment of a corporate shareholder's personal expenses as a loan is not controlling. See *United States* v. *Pomponio*, 563 F.2d 659, 663 (4th Cir. 1977), cert. denied, 435 U.S. 942 (1978). The question is whether a payment is in fact a loan, not how an accountant has classified the payment. For the payment to constitute a loan, the shareholder must intend to repay it. *United States* v. *Pomponio*, 563 F.2d at 662.

Here, the jury had ample reason to find that the payments at issue were not loans. Petitioners offered no evidence that they ever intended to treat the expenditures as loans. Petitioners never repaid the corporation for any of the expenditures, and there was no indication that they ever intended to do so. On the contrary, petitioners' conduct strongly indicated that they had no intent to repay. After the IRS audited Chesson Oil in 1980, petitioners had increased personal income tax liabilities resulting from the disallowance of personal expenses that were originally characterized as business expenses. Pet. App. 7.

Even though the problem of the companies' payment of their personal expenses was brought to their attention by the IRS, petitioners failed to change their practices or alert their accountants to the issue. The jury thus had an amply sufficient basis for concluding that petitioners did not intend to repay the corporations, but instead sought to avoid personal income taxes by characterizing personal income as deductible corporate business expenses. See *United States* v. *Scott*, 660 F.2d 1145, 1162 (7th Cir. 1981) (jury could have decided that "gifts" were compensation for official acts), cert. denied, 455 U.S. 907 (1982); *United States* v. *Bianco*, 534 F.2d 501, 505 (2d Cir.) (jury could have disbelieved defendant's cash hoard defense), cert. denied, 429 U.S. 822 (1976).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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